TESTIMONY OF A. R. WATTS

FOR

THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

DOCKET NO. 2002-2-E

IN RE: SOUTH CAROLINA ELECTRIC & GAS COMPANY

Annual Review of Base Rates for Fuel Costs

Q. WOULD YOU PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION?

A. A. R. Watts, 101 Executive Center Drive, Columbia, South Carolina. I am employed by The Public Service Commission of South Carolina, Utilities Department, as Chief of Electric.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a Bachelor of Science Degree in Electrical Engineering from the University of South Carolina in Columbia in 1976. I was employed at that time by this Commission as a Utilities Engineer in the Electric Department and was promoted to Chief of the Electric Department in August 1981. I have been in my current position since October 1999. I have attended professional seminars relating to electric utility rate design, and have testified before this Commission in conjunction with fuel clause, complaint, territorial assignment, Siting Act, and general rate proceedings.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to summarize Staff's findings as set forth in the Utilities Department's portion of the Staff Report, and address the use of a proxy for the allowable fuel component of the Company's purchased power expenses.

Q. WHAT SPECIFIC AREAS WERE ENCOMPASSED BY STAFF'S EXAMINATION?

A. The Utilities Department's examination of the Company's fuel operations consisted of a review of the Company's monthly operating reports, review of the currently approved adjustment for fuel costs tariff, and review of the Company's short-term projections of kilowatt-hour sales and fuel requirements.

Q. DID STAFF EXAMINE THE COMPANY'S PLANT OPERATIONS FOR THE PERIOD?

A. Yes, we reviewed the Company's operation of its generating facilities, including special attention to the nuclear plant operations, to determine if the Company made every reasonable effort to minimize fuel costs.

Q. HAVE YOU DETERMINED THAT ANY SITUATIONS WARRANT DETERMINATION THAT THE COMPANY HAS ACTED UNREASONABLY IN OPERATING ITS FACILITIES AND THEREBY CAUSING ITS CUSTOMERS TO BE SUBJECT TO PAYING HIGHER FUEL COSTS?

A. No. After returning to service on March 3, 2001 from an extended outage, the VC Summer nuclear station has operated very well during this review period, achieving an overall average capacity factor slightly in excess of 62 %.

The Company's major unit's availability and capacity factors are shown on Utilities Department Exhibit No. 1.

Q. WOULD YOU BRIEFLY EXPLAIN THE REMAINING UTILITIES DEPARTMENT'S EXHIBITS?

A. Exhibit Nos. 2A and 2B show the Company's nuclear and fossil unit outages for the months of March 2001 through February 2002, listing the plants by unit, duration of the outage, reason for the outage, and corrective action taken. Exhibit No. 3 lists the Company's percentage Generation Mix by fossil, nuclear, and hydro for the period March 2001 through February 2002. Exhibit No. 4 reflects the Company's major plants by name, type of fuel used, average fuel cost in cents per KWH to operate, and total megawatt-hours generated for the twelve months ending February 2002.

Exhibit No. 5 shows a comparison of the Company's original retail megawatt-hour estimated sales to the actual sales for the period under review. Exhibit No. 6 is a comparison of the original fuel factor projections to the factors actually experienced for the twelve months ending February 2002. Exhibit No. 7 is a graphical representation of the data in Exhibit No. 6. Exhibit No. 8 is the Company's currently approved Retail Adjustment for Fuel Costs tariff. Exhibit No. 9 is a history of the cumulative recovery account. Exhibit No. 10A is a table of estimates for the cumulative recovery account balance for various base level fuel factors for the period ending April 2003 including the cumulative account under-recovery balance through April 2002 of $35,689,898. This produces an overall recovery factor of 1.722 cents per kilowatt-hour that is estimated to result in an ending period over collected balance of $17,298.

Q. WOULD YOU PLEASE EXPLAIN THE PURCHASED POWER FUELPROXY PROPOSED BY THE CONSUMER ADVOCATE IN THE PRIOR CAROLINA POWER & LIGHT COMPANY FUEL REVIEW CASE HELD ON MARCH 20, 2002?

A. In the previous review of base rates for fuel costs for Carolina Power & Light Company (CP&L), under Docket No. 2002-1-E, the Commission approved a fuel factor based on a 60% fuel allowance proxy applied to purchase power activity, where the specific fuel cost was not known. This proxy was based on a request by the Consumer Advocate per a Marketer Stipulation approved in North Carolina for utilities in North Carolina, and agreed to by CP&L. The Consumer Advocate supported this proposal by referencing the South Carolina fuel clause statute language which defined "fuel cost" as, and quoting, "the cost of fuel, fuel costs related to purchased power, and the cost of SO2 emission allowances as used and shall be reduced by the net proceeds of any sales of SO2 emission allowances by the utility (emphasis added)." See S.C. Code Ann. Section 58-27-865(A) (Supp.2001). He further stated, "It does not appear that any non-fuel cost portion of purchased power costs may be recovered under the fuel clause under South Carolina law." He

went on to request the use of only 60% of CP&L's purchased power costs where the specific fuel cost is not known.

Q. DO YOU BELIEVE USE OF THIS PROXY FOR DETERMINING THE ALLOWABLE FUEL PORTION OF PURCHASED POWER EXPENSES IS THE MOST APPROPRIATE METHODOLOGY?

A. I believe there is no question that the use of some type of proxy is not only reasonable and appropriate, but also consistent with the application of the South Carolina fuel clause statute. I believe the most realistic approach, consistent with the controlling guidelines should be applied in determining the best methodology for use in this situation. I do not believe that the 60% proxy fuel factor would be the most appropriate to use in this case. Just because it may be appropriate in another jurisdiction does not mean that it is also appropriate here. Since utilities have different operations, generation mix, and power requirements, it is reasonable to conclude that it is not necessarily appropriate to use the same proxy for every one, but rather a utility specific factor may be more precise and representative of actual experience. The current use of this generic 60% fuel proxy in North Carolina was based on a range of fuel cost to total energy cost for off-system sales for the utility companies in that State; included off-system sales for NC Power; and was based on data from some period prior to August of 2001. This generic factor is also variable, and prior to the current 60% level, the factor had been set at 70%. These facts and issues show some of the weaknesses and lack of applicability of this specific factor and methodology in this case.

Q. PLEASE EXPLAIN HOW THE USE OF A PROXY IS CONSISTENT WITH THE SOUTH CAROLINA FUEL CLAUSE STATUTE.

A. In addition to the language defining "fuel cost" there are other portions that provide further guidance and insight when applying the Act in specific instances. One area addresses the offsetting of cost of fuel recovered through sales of power to neighboring utilities against fuel costs to be recovered. See Section 58-27-865(E) (Supp. 2001).Another area spells out the rebuttable presumption of prudence in operation by a utility of its nuclear generation facilities with the attaining of a certain

level of production during the review period. See Section 58-27-865(F) (Supp. 2001). Also, as I have indicated in prior fuel cases, in evaluating a utility's fuel costs under the Act, it is important to keep in mind language in section (F) pertaining to costs that can be disallowed. This section reads in part "...giving due regard to reliability of service, economical generation mix, generating experience of comparable facilities, and minimization of the total cost of providing service". I believe with this and the other language embodied in the Act, it is clear that the aim is to encourage the affected utility to operate its production system, including the purchase power option, in the most effective and efficient manner. This is in full concert with provision of electric service at the most reasonable and prudent rate, through minimization of the total cost of providing service. Consistent with this approach is the method Staff has been applying through the use of a monthly, utility specific avoidable fuel cost proxy for purchase power, where no specific fuel component was identified. This is also similar to the way the utility determines the most economical operation of its system by comparing the cost of its next available unit to the cost of purchasing the power required from another provider. A significant component of these comparisons is the cost of fuel to generate the power from the utility's own plant. I believe the objective should be to establish a proxy that most appropriately satisfies these operating criteria. As a matter of fact, this method of using the utility's avoided cost as a proxy for the fuel portion of the purchase power cost has been used for many years in determining the rate that a utility pays for power under certain contracts. These contracts are those between the utilities and Qualifying Facilities under the Public Utility Regulatory Policies Act of 1978. This Commission has approved rates based on this methodology, which is required under PURPA.

Therefore, I believe continuation of the use of the prior proxy methodology which Staff has been using is the most appropriate and prudent, and is also consistent with the South Carolina fuel statute.

In this case, the Audit Department Staff calculated a proxy factor of 63% using a like methodology for South Carolina as presented in the testimony on Ms. Cherry. An

interesting observation of the North Carolina Stipulation is that a calculation resulting in a 63% ratio of fuel cost to total energy cost for off-system sales would have meant that the applicable proxy factor would have remained at 70% in this case.

Q. WOULD YOU PLEASE EXPLAIN UTILITIES DEPARTMENT EXHIBIT NO. 10B?

A. The Audit Department Staff provided a resulting cumulative under-recovery amount of $27,089,403 as of April 2002, based on calculations using a 63% proxy factor for purchased power for the Company. In order to provide the Commission with the corresponding fuel factors resulting from application of this proxy fuel component factor, for facilitating a possible alternative decision, I have included the results on Exhibit 10 B. This Exhibit shows a breakeven point at approximately 1.677 cents per kilowatt-hour.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.